Economic Update

JUNE 11, 2021

1. INFLATION

- According to the Bureau of Labor Statistics, consumer prices rose by a seasonally adjusted 0.6% in May from the month prior. While the month-over-month reading was lower than April's growth rate (0.8% MoM), May's 5.0% year-over-year change in average prices represents the fastest rate of annual inflation since August 2008.
- Through May, food prices are up 0.4% month-over-month and 2.1% year-over-year. Annual price inflation for food and beverages is less than half of what it was in June 2020, when prices were growing at a 4.3% annual clip. Energy prices are up 27.8% from one year ago, though they were effectively unchanged from the month prior. These data reflect the supply-side sensitivities that food and energy prices are often subject to and the tendency for greater volatility.
- Core-CPI, a slimmed-down inflation measure that excludes food and energy, rose 0.7% in May following a 0.9% month-over-month increase in April. These "core' prices are up a total of 3.8% from one year ago, well above the 2% growth that policymakers peg as ideal and marks the highest rate of annual core inflation since 1992.
- Roughly one-third of the additional pricing pressures observed in May from the prior are attributable to the used cars and trucks market, which saw average prices climb a bottlenecking 7.3% month-over-month. Airfares, home furnishings, and apparel also had significant upticks as travel and leisure activities experience higher demand across the nation.
- While the incoming inflation data are jarring, take it with a grain of salt. The impact of outright price declines during April and May of last year are causing incoming data to appear inflated when reported annually. However, independent of these "base effects," month-over-month data are signaling rising pricing pressures in aggregate, which may lead to a period of sustained inflation higher than the sub-2% that had been customary in the past decade.

2. COMMERCIAL REAL ESTATE & INFLATION

- According to a new research report by the teams at Chandan Economics and SVN, commercial real estate has, historically, held up reasonably well during periods of excess inflation, preserving underlying value.
- Inflation-adjusted commercial real estate price valuations tend to grow the most during periods of low inflation. When the price level of goods and services across the entire economy grows at an average of 0-1% annually, CRE prices tend to outperform inflation by a resounding 2.5%. CRE price growth similarly beats inflation when prices of goods and services are in bands of 1%-2% or 2%-3%, posting average real returns of 2.0% and 1.7%, respectively. As inflation moves into higher ranges, CRE prices tend to keep up, though they are less likely to post price increases above inflation– a symptom of the uncertainty and tight credit

conditions often associated with these periods, which tend to be unfriendly to entrepreneurial risk-taking and value creation.
- CRE valuations perform their worst during periods of deflation. Dating back to 1953, when the U.S. economy has found itself in periods of average price declines, CRE prices would sink 4.6% more than inflation.

3. GLOBAL CORPORATE TAX MINIMUM

- Finance and Treasury officials from the G7 countries reached a tentative agreement on a new global minimum tax rate of at least 15% on corporations. The deal aims to prevent companies from shifting profits from higher-taxed nations to more favorable ones through headquarter relocations. Officials hope to use the G7 model to entice more countries to join in, particularly the G20, who are set to meet in October.
- Also contained within the agreement is the establishment of a tax on multinational corporations, such as tech giants like Amazon, Facebook, and Google, which some argue should pay additional tax due to their global operations and consumer base. American officials tried, unsuccessfully, to remove these provisions, believing that they unfairly target U.S. corporations. However, the agreement was defended by Treasury Secretary Yellen as helping to provide companies a more certain outlook of the global tax environment while establishing a standard for other nations to follow.
- The deal, negotiated on the international level by U.S. Treasury Secretary Janet Yellen on behalf of the United States, will now have to face Congressional scrutiny. While the deal itself does not immediately call for a change in U.S. tax law, the Administration is already trying to push a tax overhaul through a thinly divided Congress to fund its new American Families Plan. Some lawmakers have already criticized the G7 deal claiming that it cedes too much tax authority to other nations' governments, while others take issue with the targeting of American Multinationals.

4. JOBS REPORT

- After a historically underwhelming April Jobs Report, May's iteration proved a better case for optimism. Nonfarm employment grew by 559k positions, more than doubling the paltry 278K measured in April.
- The civilian unemployment rate re-assumed its trendline of improvement, falling by 0.3% to 5.8%. From last year's pandemic triggered high, the unemployment rate is down by a total of 9.0%, though it remains above the February 2020 low by 2.3%
- The labor force participation rate (LFPR) persists as a source of long-term concern. In May, the LFPR ticked down by 0.1%, coming in at 61.6%. The LFPR remains down by 1.8% from January 2020, and worse yet, there has been little measurable improvement in the rate since last August.
- While the LFPR for women (56.2%) remains below the LFPR for men (67.4%), the rate remains further down from men (-1.8%) than women (-1.6%) compared to January 2020 levels. Moreover, LFPR has continued to

show signs of improvement for women since the beginning of 2021, with total declines this month entirely attributable to declines in the LFPR for men.

5. OPENINGS, HIRES, & QUITS

- Job openings jumped to yet another record-high in April 2021, reaching 9.3M vacant positions. Month-over-month, openings grew an astounding 12.0%. Meanwhile, nonfarm hires totaled 6.1M in April. Excluding last summer's labor market bounce-back between May and August, the current pace of hiring exceeds all other prior observations.
- Between December 2000 (the first release of the Job Openings Labor Turnover Survey) and May 2014, the total number of nonfarm hires measured every month had exceeded the total number of job openings. In the years since the number of job openings has steadily grown more quickly. Through April 2021, the spread between openings and hires has reached an all-time high of 3.2 million, reflecting a growing labor shortage.
- Quits have similarly reached all-time highs as of the latest JOLTS release, settling up at 4.0M in April– 9.0% higher than the pre-pandemic record. Quits are often regarded as a barometer of worker confidence in labor market conditions, as people are more likely to be willing to leave their positions if they believe they could quickly find an equal or better employment setup elsewhere.

6. CONSTRUCTION SUPPLY SHORTAGES

- According to May survey data from the National Association of Home Builders, material shortages are more prevalent than at any time since the group began tracking such data.
- More than 90% of respondents reported shortages in appliances, framing lumber, and oriented strand board (OSB). For Appliances and OSB, over 50% of respondents defined the shortages as "serious." 90% of respondents also reported shortages in plywood, while 87% indicated at least some shortage in windows and doors.
- NAHB notes that the shortages are both widespread in terms of how many producers it is impacting, as well as how many materials are in shortage. Of the 24 items listed in their May survey, 12 were reported as in short supply by at least 70% of respondents, and 16 items were noted as in short supply by at least 60% of respondents.

7. BANK REAL ESTATE LENDING

- Distress continues to be effectively nonexistent on real estate loans originated by FDIC-insured bank lenders. According to the FDIC's Quarterly Banking Profile (QBP), the noncurrent rate for all real estate loans on bank balance sheets sits at 1.6% through Q1 2021. While the rate of non-performance is higher than it was

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before the start of the pandemic, it has only grown by a relatively small 49 bps.

- For loans secured by residential properties, multifamily buildings are performing better than 1-4 family residences. The noncurrent rate on loans secured by multifamily properties sits at just 0.25%, up 13 bps from their pre-pandemic low. Meanwhile, 1-4 family properties have a default rate of 2.46%, up a weightier 69 bps from their pre-COVID levels. Encouragingly, both asset types saw their default rates decline in the first quarter of the year from the prior quarter (1-4 family by 4 bps & multifamily by 1 bp).
- Construction and development loans, which tend to see higher default rates than other types of real estate loans during economic downturns, remain at subdued levels, averaging just 0.72% through Q1 2021. Bank-originated construction loans reached a GFC-high of 16.83% in 2010 and remained elevated in the high single-digits until mid-2013.
- These data reflect a few significant trends. In aggregate, there has been far less distress in real estate markets during the pandemic than early warnings called for. Further, high levels of "distressed" capital and a low yield environment are leading to competitive pricing and a lack of discounts. Lastly, following regulatory reform post-GFC, much of the risky lending that would have occurred within the commercial banking sector pre-reform has since moved to less-regulated lending sources.

8. URBAN MULTIFAMILY

- According to forecasts from Moody's Analytics REIS, the prospects for urban located Multifamily properties are turning positive in 2021. Senior Commercial Real Estate Economist, Thomas LaSalvia, notes that a "combination of returnees and first-time movers, now attracted by lower rents, will be enough to stabilize the apartment sector in key urban centers."
- Multifamily effective rents fell a record 3.0% in 2020 and are forecast to bounce back by 2.1% in 2021. Rents are expected to approach pre-pandemic levels by the end of 2022.
- Moody's Analytics REIS notes that dense gateway markets like New York, D.C., and San Francisco took the brunt of COVID's pain, though they have all likely already hit their rental rate nadirs and are back on the road to recovery.

9. SELF-STORAGE

- According to a recent analysis by Yardi Matrix, self-storage soared during the 2011-2020 period, with over 295M square feet in inventory added to the market, accounting for roughly 20% of all existing inventory in the U.S.
- Multifamily development helped spur the boom in self-storage, with both hitting a peak in 2018. Even as apartment development slowed- down during the latter years of the decade, self-storage continued to grow more rapidly as renters increasingly prioritized location over space, leading to sustained demand in the

sector.

- As the pandemic raged in 2020, self-storage remained a relatively safe corner of commercial real estate. Demand from renters moving out of urban centers and looking for more flexible living situations proved a key driver. Additionally, the emergence of remote work during the pandemic created new demand for storage units as many people suddenly needed more space in their homes.

10. BEIGE BOOK

- According to the latest Beige Book Summary, an anecdotal report produced by The Federal Reserve Bank's Board of Governors, the national economy accelerated slightly between April and May, as several districts noted positive effects on the economy stemming from increased vaccination rates and relaxed social distancing measures. Many of those surveyed also cited adverse impacts of supply chain disruptions.
- Notable increases in consumer spending were present in the leisure, travel, and restaurant sectors while sales of durable goods, such as vehicles, held steady. Still, producers continued to face constraints from supply chain challenges. Manufacturers and construction firms reported material and labor shortages in addition to delivery delays, while homebuilders noted strong demand that has begun to outpace their capacity to build.
- Two-thirds of districts reported "modest" employment growth, with the remaining third reporting "moderate" employment gains. Staffing gains have been strongest in food services, hospitality, and retail. Manufacturing also had notable increases across all districts. Hiring new workers remained a persistent challenge for many firms, with respondents noting that it is limiting output. Some moderate wage growth was reported, with some firms offering signing bonuses and increased starting salaries to attract new workers.
- Price pressures continue to mount since the last beige book report, with selling prices rising moderately, while firms reported more sharp rises in input costs. Construction and manufacturing firms reported the most cases of raw materials price pressures, but rising input costs continued to increase across the board. While supply-chain issues deepened cost pressures, strengthening demand throughout the economy has allowed many businesses to pass on much of the new costs to consumers.

SUMMARY OF SOURCES

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